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## **Is this the end of the OPEC cartel?**

### **Abstract**

*In looking at various circumstances surrounding the OPEC and the present economic crisis, one can come to a conclusion that this is the end of OPEC. This hypothesis could be supported by such factors as, falling OPEC share in the oil market, President Barack Obama's new energy policy for the United States, depleting oil reserves and the increasing worries about environmental protection. Despite these factors, it seems that the most possible scenario would be the continued strong influence of OPEC on oil prices, albeit weakened. The above hypothesis is supported by fluctuation in oil prices, rising oil demands in emerging economies like China, the dominating influence of the automobile lobby, the negative effect of bio-fuel on agriculture and finally, the underdeveloped nature of many developing countries, which in turn mean dependent on oil for years to come.*

### **1. Introduction**

The recent economic crisis and following fall in oil prices could be construed to depict the end of OPEC. Looking at various factors- the most important of which is the campaign for use of renewable energy- one can come to a conclusion that the demise of OPEC is at hand. Is this the end of OPEC? Would the rising use of renewable energy marginalize the dominating role of OPEC in determining oil prices? The goal of this article is to answer these and other important question related to the OPEC cartel.

### **1.1. The origin of OPEC**

OPEC is one of the world's oldest functioning cartels. OPEC is an organization of oil-producing governments that cooperate to manage oil supply and prices in order to maximize the revenues of the member states and promote stability in the oil market (Kohl, 2005, p.68). This is what the organization has to say about itself and its history. "The Organization of the Petroleum Exporting Countries (OPEC) is a permanent, intergovernmental Organization, created at the Baghdad Conference on September 10–14, 1960, by Iran, Iraq, Kuwait, Saudi Arabia and Venezuela. The five Founding Members were later joined by nine other Members: Qatar (1961); Indonesia (1962); Socialist Peoples Libyan Arab Jamahiriya (1962); United Arab Emirates (1967); Algeria (1969); Nigeria (1971); Ecuador (1973) – suspended its membership from December 1992-October 2007; Angola (2007) and Gabon (1975–1994). OPEC had its headquarters in Geneva, Switzerland, in the first five years of its existence. This was moved to Vienna, Austria, on September 1, 1965"<sup>32</sup>. OPEC is currently made up of 12 member states.

### **1.2. OPEC's objectives**

It states its objectives as follows: OPEC's objective is to co-ordinate and unify petroleum policies among Member Countries, in order to secure fair and stable prices for petroleum producers; an efficient, economic and regular supply of petroleum to consuming nations; and a fair return on capital to those investing in the industry<sup>33</sup>.

In plain terms, OPEC's goal as a cartel is to regulate petroleum prices by regulating the amount of petroleum that is being produced by its member countries.

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<sup>32</sup> The Organization of Petroleum Exporting Countries (OPEC) <http://www.opec.org/aboutus/history/history.htm> (Date of entry 19th December 2008)

<sup>33</sup> Ibid.

### 1.3. OPEC over the years

The influence of OPEC over the years has been varied though. Some of the countries, notably the Arab countries, have also used oil as an instrument of politics. In his article- *Will OPEC survive?* Manochehr Dorraj writes "During the Arab oil embargo of 1973, the Arab states attempted to use oil as a political weapon to punish the United States for its support of Israel (Dorraj, 1993, p.19)."

The following years were followed by struggle within the cartel between the so called "hawks" (Libya and Iran) and the "doves" (Saudi Arabia, Kuwait and United Arab Emirates). At the peak of this struggle, Saudi Arabia decided to flood the market with oil which led to oil glut and the fall of oil prices to a record low of 10 USD per barrel in 1986.<sup>34</sup>

Three hypotheses are offered by analysts to explain the root of the 1986 oil price crash and decipher its possible consequences. First, some scholars have asserted that the 1986 loss of control over prices was related to OPEC's failure to use and effectively manipulate the changes in the world petroleum market in a more forward-looking strategy (Adelman, 1987, p.47). Others blamed the cartel's loss of power on economic and political situations outside of the organization's control (Griffin and Teece, 1982, p.65). Yet a third group contended that the only channel of survival available to the organization was to pursue a production reduction and price cutting policy (Dorraj, 1993, p.19).

To complicate issues, the market share of OPEC has been on the decline. OPEC went from nearly 60% of the western world oil supply to giving 32% in 1984. Looking at the turmoil of the 1980s and comparing them to energy issues faced today- there seem to be an escalation with oil prices reaching 150 USD at its peak.

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<sup>34</sup> The Organization of Petroleum Exporting Countries (OPEC)  
<http://www.opec.org/aboutus/history/history.htm> (Date of entry 19th December 2008)

## 2. Factors affecting crude oil prices

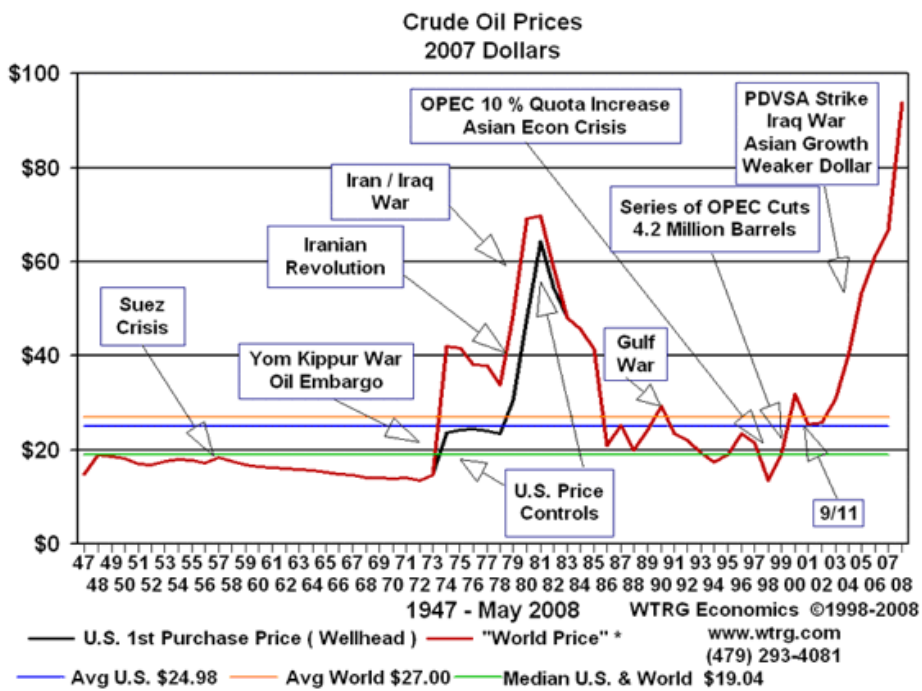
Crude oil prices are affected by the following factors.

1. Political situation.
2. Energy/Oil Consumption or demand.
3. Oil supply.

The influence of the above three factors can be seen in the following graphs.

### 2.1. Political situation and oil prices

Graph 1. Crude Oil Prices 1947 - May, 2008



Source: J. L. Williams, <http://www.wtrg.com/prices.htm> (Date of entry: 19th December 2008).

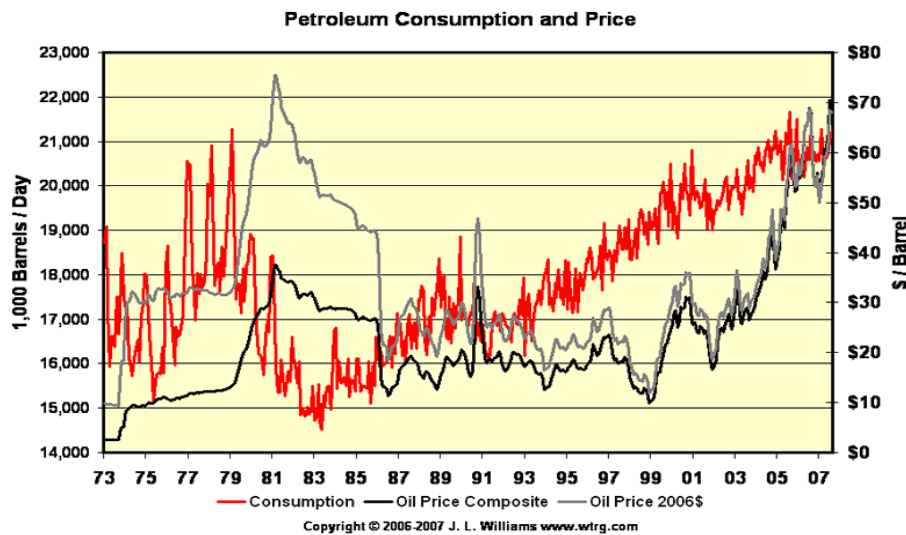
The above table shows the fluctuations in oil prices from 1947 to 2008. It is notable that at times of political crises or instabilities, oil prices rise and fall during times of political stability. Most notable of the above crisis situations were:

- The Yom Kippur War oil embargo in 1973 when oil prices rose from below 20 USD per barrel to more than 40 USD per barrel,
- Iranian revolution and the proceeding war between Iran and Iraq (late 1979 to early 1980s). Oil prices rose from below 40 USD to about 75 USD per barrel,
- The Gulf war in 1990 saw oil prices rise from about 20 USD to about 30 USD per barrel,
- The Iraqi invasion, conflict with Iran and the rising demands of oil in Asia led to the rise in oil prices in 2003 from 25 USD to about 150 USD in 2008.

Thus international political situation plays a very important role in oil prices as do demand and supply.

## 2.2. Energy/Oil Consumption or demand and oil price

Graph 2. U.S. Petroleum Consumption



Source: J. L. Williams, <http://www.wtrg.com/prices.htm> (Date of entry: 19th December 2008).

The graph above shows the oil consumption (demand) of the United States which is the highest oil consumer, accounting for 25% of the world oil consumption. The above graph shows the higher the oil consumption in the US the higher oil prices rise. It is interesting to note that at around 1981, oil consumption dropped drastically because of the exorbitant price of oil. This led to a consistent and significant fall in the price of oil throughout the rest of the 1980s. As shown in the table below, United States consumes more than 20 million bbl/day even higher than all of the EU nations together. The implication of this is that the level of oil consumption in the US often has a direct effect on oil prices worldwide.

**Table 1. Ranking of the world highest consumers of oil according to the CIA world factbook**

Rank	Country	Oil - consumption (bbl/day)	Date of Information
	<a href="#">World</a>	80,290,000	2005 est.
	<a href="#">United States</a>	20,800,000	2005 est.
	<a href="#">European Union</a>	14,550,000	2004
	<a href="#">China</a>	6,930,000	2007 est.
	<a href="#">Japan</a>	5,353,000	2005
	<a href="#">Russia</a>	2,916,000	2006
	<a href="#">Germany</a>	2,618,000	2005 est.
	<a href="#">India</a>	2,438,000	2005 est.
	<a href="#">Canada</a>	2,290,000	2005
	<a href="#">Korea, South</a>	2,130,000	2006
	<a href="#">Brazil</a>	2,100,000	2006 est.
	<a href="#">Mexico</a>	2,078,000	2005 est.
	<a href="#">Saudi Arabia</a>	2,000,000	2005
	<a href="#">France</a>	1,999,000	2005 est.
	<a href="#">United Kingdom</a>	1,820,000	2005 est.
	<a href="#">Italy</a>	1,732,000	2005 est.

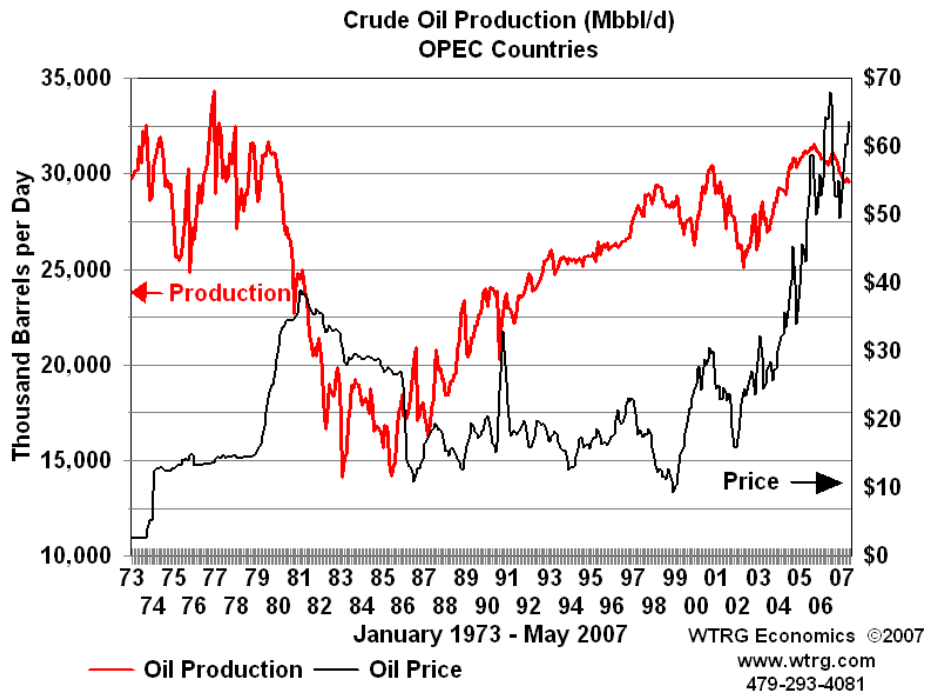
<a href="#">Iran</a>	1,630,000	2006 est.
<a href="#">Spain</a>	1,600,000	2005 est.
<a href="#">Indonesia</a>	1,100,000	2006 est.
<a href="#">Netherlands</a>	1,011,000	2006
<a href="#">Thailand</a>	929,000	2005 est.

Source: CIA world factbook

<https://www.cia.gov/library/publications/the-world-factbook/rankorder/2174rank.html> (date of entry: 18th December 2008).

### 2.3. Oil supply and oil price

Graph 3. OPEC Production & Crude Oil Prices



Source: J. L. Williams, <http://www.wtrg.com/prices.htm> (Date of entry: 19th December 2008).

From the above graph we can deduce that the higher the production (supply) the lower the oil price- *ceteris paribus*. This trend seem to be consistent looking at the level of OPEC oil production and the following crude oil prices between 1973 and 2007. We can also see rising oil productions from about 1986 from below 15 million barrels per day to about 30 million barrels per day in 2007 because of rising energy demands.

Having analyzed this general overview, let us now look at the factors that support these two schools of thought.

### 3. Factors in support of OPEC's end

The factors that support the hypothesis that OPEC is reaching its end include the following:

1. **Decrease in OPEC control:** There Has been decreasing control of OPEC's share in the oil market from 60% in the 1970s to about 40% presently. Whether this decrease will continue is yet to be seen.
2. **Obama's new energy policy for the USA :** A key factor to the future of OPEC might be Barack Obama's energy policy. United States being the highest consumer of energy, its energy policies have a far reaching effect on the rest of the world. If he makes good his promise to seek other sources of energy- that would definitely lead to lower oil demand and falling oil prices.
3. **Depleting oil reserves:** Proved reserve of oil worldwide is at 1,143.355 billion barrels<sup>35</sup>. Proved reserves are estimated quantities that analysis of geologic and engineering data demonstrates with reasonable certainty are recoverable under existing economic and operating conditions<sup>36</sup>. Continued use of oil will eventually lead to its terminal depletion.
4. **Worries about climate and environmental protection:** Another reason for the hypothesis that OPEC's time may be coming to an end is the rising concern for the climate change due to global warming. If most of the policies being proposed during different climate conferences are put into effect, this will lead to reduction and indeed marginalization of oil producing countries.

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<sup>35</sup> Energy Information Administration, <http://www.eia.doe.gov/emeu/international/reserves.html>  
(Date of entry: 19th June 2008)

<sup>36</sup> Ibid.



#### 4. Factors in support of OPEC's continued existence

These factors include:

1. **Fluctuation in oil prices:** Oil prices have been on the decrease after reaching a record high of about 150 USD per barrel. At the time of writing this article, the price of oil was at 45 USD per barrel. This led the OPEC countries to cut oil production (17<sup>th</sup> December 2008) by 2,2 million barrel to raise prices to 75 USD per barrel. Such price fluctuations favors the existence of OPEC as a price stabilizer.
2. **Rising oil demands:** The demand in oil will continue to rise and many oil fields are being discovered. China, the third largest consumer of oil after USA and European Union, has a population of over 1,3 billion people. For its economy to continue to grow, it will need unprecedented amount of energy. In the last 5 years it has made inroads into Africa- building partnerships especially with the oil producing countries like Nigeria and Angola.
3. **Low technological level of many developing countries:** The technological level of developing nations is such that it will take very long for any new source of energy to be adopted. The process of implementing such change is usually long and expensive.
4. **The automobile and oil lobby:** The next very important reason why this may not happen is the automobile and the oil industry lobby. Innovative sources of fuel have been available for many years but these lobbies have been very effective in preventing wider implementation and adoption. Such inventions have remained as prototypes.
5. **Bio-fuel effect on agriculture:** Another very worrying effect, if bio-fuels are adopted on a larger scale as replacement or supplement for oil, is the rise in food price due to use of farmland to produce oil raw materials instead of food. The effect for poor nations and third world countries would be devastating.

## 5. Conclusion

Looking at the above factors, we can make the following conclusions.

Firstly, although the trend, in the western world, will be towards environmentally friendly sources of sustainable energy, the use of crude oil and thus the influence of OPEC will continue to be strong in the coming years especially as energy demands continue to grow in emerging economies like China and India.

Secondly, as new sources of energy begin to be more common, many of the oil producing nations, whose economies are heavily dependent on oil, will go through economic hardship and will be forced to diversify into other sources of income. In addition to the above, many of these nations have the largest natural gas reserves. Would the energy cartel of the future be gas based instead of oil based? Time will tell.

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